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October 1, 2003

**VIA FACSIMILE AND U.S. MAIL**

Mr. Wade L. Nash, Esq.
Missouri Bankers Association
207 E. Capitol Avenue
P.O. Box 57
Jefferson City, MO 65102

Re: Loan Participations under the Missouri Securities Act of 2003;
Interpretive Opinion – File No. 2003-01041; IO-13-03

Dear Mr. Nash:

In your letter of September 17, 2003, you requested that the commissioner of securities provide an interpretive opinion in regard to the following issues: (1) whether traditional loan participations between banks would constitute an offer or sale of securities under the Missouri Securities Act of 2003 (the "Missouri Securities Act"); and (2) whether bank personnel are excluded from the definition of "investment adviser" and "investment adviser representative" under the Missouri Securities Act (collectively, the "Request"). The commissioner of securities will address the second issue concerning the definition of investment adviser and investment adviser representative in a separate letter. Note that the following interpretive opinion of the commissioner is authorized by §409.6-605(d) of the Missouri Securities Act.

In the Request, you cite a treatise entitled "The Securities Activities of Banks" by Melanie Fine, third edition, Aspen Law and Business, 2001, and you state that the treatise describes a loan participation as follows:

> " A loan participation is an interest in a loan originated by another lender which issues undivided fractional interests in the loan. A loan participation is distinct from a loan syndicate where each syndicate member extends credit directly to the borrower. A participating lender typically has no direct legal relationship with the borrower but rather relies on the originating or 'lead' bank to hold the loan collateral in trust and collect and distribute principal and interest payments to the participating lenders. The rights and obligations of the parties are governed by a loan participation agreement. Courts have ruled that the lead lender does not have a fiduciary duty to loan participants in the absence of unequivocal contractual language creating such a relationship."

In the Request, you state that you believe "in general, commercial banks that offer loan participations to other commercial banks or institutional investors are not engaging in the purchase or sale of securities." You further state that you believe that the sale of a loan participation with the characteristics listed in the Request[1] is not a purchase or sale of securities.

The commissioner of securities is of the opinion that the relevant test to determine whether loan participations are notes within the definition of a "security" pursuant to the Missouri Securities Act is the "family resemblance" test as set forth by the U.S. Supreme Court in Reves v. Ernst & Young.[2] The "family resemblance" test in Reves begins with the presumption that every note is a security. Id. at 65. However, the Court recognized a list of instruments commonly denominated as notes that are not included in the category of notes that fall under the definition of a security. Id. In addition, if a note is not sufficiently similar to the enumerated list of instruments, then a court must consider whether the note meets the standard that resembles the enumerated list of instruments. Id. at 66.

The standard consists of the following four factors:

(1) "An examination of the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a 'security'. . . . If the note . . . is to advance some other commercial or consumer purpose . . . the note is less sensibly described as a 'security.'" Id.

(2) "[E]xamine the 'plan of distribution' of the instrument . . . to determine whether it is an instrument in which there is 'common trading for speculation or investment.'" Id. (citing SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 64 S.Ct. 120, 88 L.Ed. 88 (1943)).

(3) "[E]xamine the reasonable expectations of the investing public: The Court will consider instruments to be 'securities' on the basis of such public expectations . . ." Id.

(4) "[E]xamine whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Act unnecessary." Id. at 67. (citing Marine Bank v. Weaver, 455 U.S. 551, 102 S.Ct. 1220, 71 L.Ed.2d 409 (1982)).

[1] The facts listed in the Request are as follows: "(1) [T]he loan participants are commercial banks or sophisticated commercial investors that routinely purchase and sell loan notes or participations; (2) the loan participants enter into a written agreement and acknowledge that the economic substance of the transaction is a loan made to the original borrower; (3) a fair amount of information about the loan is provided about the borrower, and the loan participant may seek more information from or about the borrower; (4) the loan participant is capable of being involved in administrating the loan; (5) the loan participant has the opportunity for direct contact with the borrower; (6) the minimum size of loan participations sold are significant amounts; (7) the number of loans are small; (8) the originating bank retains for its own account a portion of the loan; (9) the participation agreements are in place prior to disbursement of the loan; (10) the originating bank makes no agreement or arrangement with respect to a secondary market in which notes or participations may be sold; and, (11) the loan participations purchased are loans of the type which the originating bank would keep on its own books."

[2] 494 U.S. 56, 110 S.Ct. 945, 108 L.Ed.2d 47 (1990).

The commissioner of securities is of the opinion that in determining whether loan participations are notes under the definition of a security would depend upon the facts of each specific case and the application of the "family resemblance" test to those particular facts. The commissioner is of the opinion that the factors in Banco Espanol de Credito v. Security Pacific National Bank, et al,[3] would be applicable in the analysis of whether a specific loan participation meets the standard under the "family resemblance" test if a bank effects transactions in a loan participation with other banks. However, the commissioner is of the opinion that a loan participation involving entities, other than traditional banking institutions, would not necessarily fall outside the definition of a security under the Missouri Securities Act.[4] Loan participations sold to sophisticated commercial investors may be securities, depending on the overall motivation of the investor.

Nevertheless, as noted in the Request, under the Missouri Securities Act, a bank is excluded from the definition of broker-dealer if its activities as a broker-dealer are limited to those specified in, among others, subsection 3(a)(4)(B)(ix) of the Securities Exchange Act of 1934 (the "Exchange Act"). Section 3(a)(4)(B)(ix) of the Exchange Act includes activities by a bank in effecting transactions in identified banking products as defined in section 206 of the Gramm-Leach-Bliley Act. Identified banking products under section 206 of the Gramm-Leach-Bliley Act include loan participations sold to a "qualified investor." Section 3(a)(54)(A)(iii) of the Exchange Act defines "qualified investor" to include, among others, any bank, investment company registered with the U.S. Securities & Exchange Commission, insurance company, broker, dealer, and any corporation or natural person who owns and invests on a discretionary basis not less than $25,000,000 in investments. Thus, in general, a bank effecting transactions in a loan participation with qualified investors, as defined under the Exchange Act, is excluded from the definition of broker-dealer and from the broker-dealer registration requirements under the Missouri Securities Act.

Based on the facts presented in your correspondence, we are of the opinion that the relevant test in analyzing whether loan participations are notes within the definition of the term "security" under the Missouri Securities Act is determined by the "family resemblance" test as set forth by the U.S. Supreme Court in Reves. Also, in applying this test, a loan participation involving entities other than traditional banking institutions would not necessarily fall outside the definition of a security under the Missouri Securities Act. However, a bank effecting transactions in a loan participation with qualified investors, as defined under the Exchange Act, is excluded from the definition of broker-dealer and from the broker-dealer registration requirements under the Missouri Securities Act.

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[3] 763 F. Supp. 36 (S.D.N.Y. 1991) aff'd 973 F.2d 51 (2d Cir. 1992). In Banco Espanol de Credito the U.S. District Court applied the "family resemblance" test to a loan participation and held that the notes were not securities. The Second Circuit affirmed the District Court's decision.

[4] In Banco Espanol de Credito, the dissent opinion of the Second Circuit noted that the loan participations would be securities under the "family resemblance" test based on the fact, among others, that the loan participations were sold to other entities besides traditional banks.

This opinion is based on the facts presented in your correspondence, and should the facts prove to differ from those presented, the opinion of this office may differ.

Sincerely,

Douglas M. Ommen
Commissioner of Securities